



Signed: March 26, 2010

Leslie Tchaikovsky

LESLIE TCHAIKOVSKY
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

In re

No. 06-41774 T
Chapter 9

WEST CONTRA COSTA HEALTHCARE
DISTRICT, etc.,

Debtor.

UECKER & ASSOCIATES, INC., as
Trustee for the DOCTORS MEDICAL
CENTER TRUST FOR THE BENEFIT OF
CREDITORS,

A.P. No. 08-4242 AT

Plaintiff,

vs.

TENET HEALTHSYSTEM HOSPITALS,
INC.,

Defendant.

MEMORANDUM OF DECISION ON CROSS-MOTIONS FOR SUMMARY JUDGMENT

In the above-captioned adversary proceeding, plaintiff Uecker & Associates, Inc., as trustee for the Doctor's Medical Center Trust for the Benefit of Creditors under a confirmed plan, (the "Trustee") seeks to avoid and recover certain lease payments made pre-petition

1 by the debtor (the "Debtor")¹ to defendant Tenet Healthsystem
2 Hospitals, Inc. ("Tenet") and to object to its claim unless the
3 payments are repaid. The complaint is based on 11 U.S.C. §
4 548(a)(1)(B) which authorizes the avoidance of obligations that are
5 constructively fraudulent: i.e., not made with actual intent to
6 defraud but which have a fraudulent effect on other creditors because
7 they are incurred when the debtor is insolvent or render the debtor
8 insolvent.

9 Defendant filed a motion for summary judgment, contending that
10 the Trustee was unable to establish a necessary element of the claim:
11 i.e., that the Debtor was either insolvent when the obligation was
12 incurred or was rendered insolvent by it. The Trustee filed a cross-
13 motion, contending that it was entitled to a summary adjudication in
14 its favor on the issue of insolvency. The motions were heard
15 together on March 4, 2010 and taken under submission. Thereafter,
16 without leave, although seeking leave, the Trustee filed a post-
17 hearing brief. Tenet objected to the post-hearing brief but also
18 addressed its contentions.

19 As set forth below, the Court concludes that Tenet is entitled
20 to summary judgment in its favor. The Court has considered both the
21 post-hearing brief and Tenet's response in reaching its decision.
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26 ¹The Debtor is West Contra Costa Healthcare District, a
political subdivision of the State of California, doing business as
Doctor's Medical Center.

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SUMMARY OF FACTS

On or about March 2001, Tenet entered into a lease with Pinole Medical Development Co. ("Pinole") of a general acute care hospital and related facilities located in Pinole, California (the "Pinole Facility"). In August 2004, the Debtor entered into a sublease of the Pinole Facility from Tenet. The original sublease did not require the Debtor to pay monthly lease payments to Tenet. The original sublease was amended several times. The November 2004 and April 2005 amendments still did not require the Debtor to make lease payments. However, the third amendment, in May 2005, required the Debtor to make a lease payment for June 2005.

On July 1, 2005, the Debtor and Tenet entered into a new sublease agreement for the Pinole Facility (the "Sublease"). The Sublease required the Debtor to make monthly lease payments, beginning with a payment of \$41,000 in July 2005, increasing each month thereafter to \$83,333.33 in November 2005 and continuing at that rate thereafter through February 2021 unless the Sublease was terminated sooner. As part of the terms of the Sublease, the Debtor was required to provide Tenet with a letter of credit in the amount of \$1.5 million upon which Tenet was permitted to draw if the Debtor failed to make the lease payments.

From July 1, 2005 through September 30, 2006, the Debtor paid Tenet \$980,000 in lease payments. On October 1, 2006, the Debtor filed its chapter 9 petition, commencing the above-captioned case. On November 20, 2006, the Court authorized the Debtor to reject the Sublease. Tenet was authorized to draw on the letter of credit and

1 did so, receiving \$1.5 million from the issuer of the letter of
2 credit.

3 DISCUSSION

4 A. APPLICABLE LAW

5 1. Law Applicable to Summary Judgment Motions

6 Summary judgment motions are governed by Rule 56 of the Federal
7 Rules of Civil Procedure which is made applicable to this proceeding
8 by rule 7056 of the Federal Rules of Bankruptcy Procedure. Rule 56
9 provides that summary judgment can and should be provided, either on
10 all or a part of a claim, when the evidence provided demonstrates
11 that there is no genuine issue as to any material fact.
12 Fed.R.Civ.Proc. 56(c)(2). A disputed fact is material only if its
13 resolution affects the outcome of the case. Anderson v. Liberty
14 Lobby, Inc., 477 U.S. 242, 248 (1986).

15 An issue is genuine if the evidence makes it possible for the
16 trier of fact to decide in favor of the non-moving party. Id.
17 However, an inquiry into the materiality of a fact and its potential
18 significance is not necessary where a party fails to establish the
19 existence of an element essential to that party's claim. A moving
20 party is entitled to summary judgment on a claim when the non-moving
21 party, in opposition to the motion, fails to present evidence
22 sufficient to support a finding in its favor on an essential element
23 of its claim. Celotex Corp. v. Catrett, 477 U.S. 317, 322-23
24 (1986).

1 **2. Law Applicable to Avoidance of Constructively**
2 **Fraudulent Transfers**

3 Section 548 of the Bankruptcy Code provides, in pertinent part,
4 that a trustee may avoid as fraudulent an obligation incurred by the
5 debtor within two years of the debtor's filing for bankruptcy, as
6 fraudulent if: "the debtor (i) received less than a reasonably
7 equivalent value in exchange for...[the] obligation; and (ii)[I] was
8 insolvent on the date that...such obligation was incurred, or became
9 insolvent as a result of such...obligation[.]" 11 U.S.C. §
10 548(a)(1),(b)(i)-(ii). A debtor that is a municipality is
11 "insolvent" if it is "(i) generally not paying its debts as they
12 become due unless such debts are the subject of a bona fide dispute;
13 or (ii) unable to pay its debts as they become due." 11 U.S.C. §
14 101(32)(C).

15 **B. ARGUMENT**

16 The Trustee's complaint alleges that the Debtor was either
17 insolvent when it entered into the Sublease or was rendered insolvent
18 by doing so. However, the Trustee failed to present any evidence or
19 argument to support her allegation that entering into the Sublease
20 caused the Debtor to become insolvent. Therefore, the only issue the
21 Court will address is whether the Debtor was insolvent when it
22 entered into the Sublease.

23 As noted above, the Bankruptcy Code test for the insolvency of
24 a municipality such as the Debtor has two prongs: (1) whether the
25 debtor was generally paying its undisputed debts as they came due and
26 (2) whether the debtor was able to pay its debts as they came due.

1 The relevant time for determining whether the Debtor was insolvent
2 when it entered into the Sublease is July 1, 2005, just before the
3 Sublease was executed. The relevant time for determining whether the
4 Debtor was rendered insolvent by entering into the Sublease is
5 prospective. It considers the Debtor's likely ability to pay its
6 debts during the balance of the fiscal year-i.e., through the end of
7 2005. See In re City of Bridgeport, 129 B.R. 332, 336-38 (Bankr. D.
8 Conn. 1991).²

9
10 **1. The Debtor was generally paying its debts when it entered
into the Sublease.**

11 The Trustee's principal argument in support of its cross-motion
12 was that the Debtor was not generally paying its debts as they came
13 due in 2005. Her evidentiary support for this argument is seven
14 proofs of claim filed in the bankruptcy case, reflecting debts
15 incurred during 2005, which remained unpaid when the bankruptcy case
16 was filed in October 2005. This evidence is insufficient as a matter
17 of law to establish that the Debtor was not generally paying its
18 debts as they came due as of July 1, 2005.

19 The Trustee concedes that many of the debts reflected in the
20 seven proofs of claim were incurred after July 1, 2005. She has not
21 provided a separate figure for those incurred up to July 1, 2005.
22 However, even if all of the debts had been incurred before July 1,

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24 ²The issue of insolvency arose in the Bridgeport case as a
25 question of eligibility to file a chapter 9 petition. It is
26 arguable that this prospective view of a debtor's ability to pay
should not be applied in a fraudulent transfer action. However,
both parties have assumed that it should apply, and the Court
concludes that its application does not change the outcome the
decision.

1 2005, they would not be sufficient to establish insolvency at the
2 time the Debtor entered into the Sublease.

3 The Debtor's financial records establish that its operating
4 expenses in June 2005 were approximately \$10 million and in July
5 approximately \$11 million. The Debtor's failure to pay \$1.3 million
6 of those expenses would not be sufficient to establish that the
7 Debtor was "generally not paying its debts." Moreover, as Tenet
8 points out, the Trustee has failed to offer any evidence that some
9 or all of the debts were not being paid because they were disputed.

10 **2. The Debtor was able to pay its debts as they came due both**
11 **before entering into the Sublease and during the balance**
12 **of 2005.**

13 As noted above, the Debtor's ability to pay is examined
14 prospectively, taking into account the balance of the Debtor's fiscal
15 year. The Debtor's financial records clearly demonstrate that it
16 was losing money every month and that its financial condition was
17 deteriorating. However, Tenet notes that the Debtor's financial
18 records demonstrate that, even at the end of December 2005, the
19 Debtor's cash reserves exceeded the amount of its payables. Thus,
20 according to Tenet, it was able to pay its debts by resorting to its
21 cash reserves.

22 The Trustee argued that the cash reserves should not be taken
23 into account because the Debtor would not have been exercising good
24 business judgment if it had exhausted its cash reserves. Maybe so.
25 However, the test for insolvency does not question whether the Debtor
26 should have done so, simply whether it could have done so.

1 In her post-hearing brief, the Trustee argues that the Debtor's
2 financial records demonstrated that, as of November 2005, the Debtor
3 was unable to pay its debts. At that time, the total of the Debtor's
4 cash and investments and market securities was only approximately \$9
5 million whereas its total accounts payable and payroll related
6 liabilities were approximately \$9.5 million. The shortfall in
7 December 2005 was even larger. Moreover, she notes, these figures
8 do not include the Debtor's current liabilities, which she estimates
9 exceeded \$400,000 in November and December 2005. However, as Tenet
10 responds, the Trustee ignores the approximately \$10 million revenue
11 stream that the Debtor received each month and used to pay its
12 operating expenses. Thus, this argument is unpersuasive.

13 The Debtor's final piece of evidence is the declaration of Dev
14 Mahadevan ("Mahadevan"), the Debtor's Chief Financial Officer. In
15 his declaration, Mahadevan notes that, at a meeting of the Board of
16 Directors on June 28, 2005, he advised the Board that, "if [the
17 Debtor's] losses continued at the current rate, the District could
18 exhaust its reserves in four months, by September 2005." As a result
19 of this advice, the Trustee notes, the Debtor undertook extensive
20 cost-cutting measures, including delaying payments to those vendors
21 it believed were not critical or would not respond by discontinuing
22 shipment of necessary supplies.³

24 ³The delay in payment to vendors could have supported a
25 finding that the Debtor was generally not paying its debts as they
26 came due if evidence had been provided that the delays occurred
before July 1, 2005 and involved the majority of the Debtor's
current payables. However, given the timing and lack of
specificity of the evidence presented, it does not.

1 A copy of the minutes from the meeting are attached to
2 Mahadevan's declaration. The following statements appear immediately
3 after the language quoted by the Trustee: "Administration has
4 reviewed each department and has met nearly everyday to review
5 opportunities for saving expenses. The goal is to reduce expenses
6 by \$50,000 per month and meet the original budget by the year-end."⁴

7 As discussed above, clearly, the Debtor was successful in
8 reducing its expenses so as to pay its debts generally as they became
9 due through the end of 2005 so as to avoid exhausting its cash
10 reserves. By contrast, the City of Vallejo was found to be insolvent
11 when it was unable to reduce its expenses without endangering the
12 public health and safety. See In re City of Vallejo, 408 B.R. 280,
13 294 (Bankr. 9th Cir. 2009). Thus, the Court concludes that, even
14 viewed prospectively, the Debtor had the ability to pay its debts as
15 they came due.

16 CONCLUSION

17 Tenet's motion for summary judgment will be granted, and the
18 Trustee's cross-motion for partial summary judgment will be denied.
19 The Trustee has not presented any evidence nor has it argued that
20 entering into the Sublease caused it to be insolvent. In addition,
21 the Trustee has failed to present sufficient evidence to sustain a
22 finding that either the Debtor was not generally paying its debts as
23 they came due or that, viewed prospectively, it would be unable to
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25 ⁴The \$50,000 reference in the minutes appears to be a
26 typographical error. Mahadevan's declaration states that the goal
was to reduce expenses by \$500,000. This figure appears more
plausible given the amount of the Debtor's monthly expenses.

1 pay its debts on a timely basis during the rest of 2005. Since all
2 of the other claims asserted in the complaint depend on the Trustee's
3 success on her claim for avoidance of the obligation represented by
4 the Sublease, Tenet is entitled to summary judgment on those claims
5 as well. Tenet is directed to submit a proposed form of order and
6 judgment in accordance with this decision.

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